AgriBank

October 22, 2014

Barry F. Mardock
Deputy Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22101-5090

Dear Mr. Mardock:

Thank you for the opportunity to comment on the Farm Credit Administration's (FCA's) proposed rule regarding the investment authorities for Associations and Banks of the Farm Credit System. On behalf of the AgriBank District, this letter provides comments on Association investment regulations in proposed Section 615.5142 of the regulations, as published July 25, 2014 in the Federal Register. This letter also highlights AgriBank's support of the consensus view of System institutions regarding the proposed rule as it applies to Banks.

Association Investment Regulations

<u>Proposed 615.5142 (a) - Investment Eligibility Criteria</u>

Proposed 615.5142 (a) would authorize each System Association, with the approval of its funding Bank, to manage risk by purchasing and holding obligations that are issued by, or are fully guaranteed or insured as to the timely payment of principal and interest by, the Unites States or any of its agencies in an amount that does not exceed 10 percent of its total outstanding loans.

We applaud FCA's recognition that the risks Farm Credit Banks and their respective Associations face are multifaceted, and agree that current requirements for Association investments—which specify only the two eligible purposes of reducing interest rate risk (IRR) and managing surplus short-term funds — are too restrictive and do not provide Associations the flexibility to manage their risks in today's environment. The proposed rule would grant to Associations greater flexibility to hold investments for other risk management purposes, including concentration risk. We agree that such modernization is in the best interest of the System. However, we urge FCA to clarify that the proposed limitation on Association investment portfolio size does not apply to certain investments authorized under other sections of FCA regulations. In addition, we ask FCA to reconsider the limit on the size of Association investment portfolios by specifying the limit as a percent of either earning assets or total assets, rather than as a percentage of loans. Our rationale for these requests is provided in our comments below.

<u>Comment 1.</u> FCA requested comments on whether the proposed rule should identify specific purposes for Associations to purchase and hold investments. We believe that this proposed rule should <u>not</u> identify specific purposes for Associations to purchase and hold investments.

In general terms, the purpose of Association investments is, in FCA's words, "to manage risks"; or in greater detail, "…to appropriately manage and diversify risks while serving their primary mission of funding agriculture and rural America." We believe any attempt to further enumerate the specific purposes for which Associations may purchase and hold investments – beyond the purpose of "...to manage risks"—will prove to be inflexible and unnecessarily restrictive, particularly in future years.

As FCA notes, U.S. government issued or guaranteed investments are generally liquid and pose virtually no credit risk, although they do pose market risk. Investments may help Associations diversify concentration risk as single-industry lenders. A limit on Association investment portfolio size will ensure "… that loans to eligible borrowers always constitute the vast majority of System assets, which is consistent with the mission of each Association."

Comment 2. We urge FCA to clarify that certain balance sheet components are to be excluded from the 10 percent of loans investment limit. FCA should ensure that the 10 percent of loans limit does not unintentionally detract from authorized business practices appropriate to our mission. Specifically, FCA should clarify that the language pertaining to the proposed 10 percent limit is aimed at investments used for the purpose of risk management, and explicitly excludes other specific investment items, such as investments in Farmer Mac (FMAC) mortgage-backed securities (MBS), Agriculture and Rural Community (ARC) bonds/Rural America Bond (RAB), investments in Rural Business Investment Companies (RBICs), and investments in Unincorporated Business Entities (UBEs).

- The size limitation should exclude investments in FMAC MBS, as authorized under Section 615.5174, "…for the purposes of managing credit and interest rate risk, and furthering your mission to finance agriculture." This regulation further limits the total size of Farmer Mac securities investments as, "the total value of your Farmer Mac securities cannot exceed your total outstanding loans." Use of FMAC for credit or capital purposes should not create limits in other areas of risk management.
- The size limitation should exclude ARC/RAB bonds, which are authorized by FCA under existing Section 615.5140 (e). Although some may include partial or conditional government guarantees, these mission-related securities are often treated as loans under GAAP accounting, and are a fulfillment of our mission to agriculture and rural America. We believe that all mission-related investment activity should be excluded from the limit on investments for risk management purposes.
- The size limitation should exclude investments in UBEs. UBEs are generally created to manage complex workout situations or to efficiently structure programs that allow Associations to collaborate on customer-oriented programs and services in the fulfillment of our mission and authorized under Section 611.1153. Such UBE investments are considered equity investments for many and should not be considered when calculating risk management investments. These investments are already limited to 1 percent of loans (unless otherwise approved by FCA) under 611.1153 (h).
- The size limitation should exclude investments in RBICs, whose authority is in accordance with title VI of the Farm Security and Rural Investment Act of 2002 and regulations issued by USDA (7 CFR 4290.10 through 4290.3099). FCA has the authority to ensure that a System institution's investment in a RBIC is safe and sound, and that it operates the RBIC in accordance with law and regulation.

In addition, we believe purchases of USDA guaranteed loans should be exempted from the association investment portfolio size limitation. As noted in the Agency's comments (footnote 33), the Farm Credit Act (Act) authorizes System institutions to buy and sell obligations of, or insured by, the United States or any agency thereof. Consistent with the Act, the current Section 615.5140(a) lists "obligations fully insured or guaranteed" by the United States or its agencies among eligible investments for Banks and Associations, which includes investments in loans guaranteed by the USDA under its various programs. In its Informational Memorandum (IM) dated March 22, 2011, FCA discusses at length the purchase of USDA guaranteed loans, citing both Section 615.5140(a) and 615.5140(e) as authority for these investments. The IM lists several important mission-related benefits to the purchase of USDA guarantees, such as increased credit availability to Farm Credit eligible borrowers, improved liquidity for agricultural lenders and providing capital for agricultural investments and rural homes. Investments in USDA guaranteed loans occupy the rare position of being authorized under multiple sections and being recognized by FCA as mission-related and "of the highest quality." As such, we suggest FCA include in Section 615.5142 an exemption for investments in USDA guaranteed loans from the Association 10 percent limit for investments. Such an exemption would be consistent with the exemption for these investments from portfolio diversification requirements for Farm Credit Banks under proposed Section 615.5133(f)(2)(i). More importantly, this exemption would ensure continuing benefits to agriculture and rural America through Farm Credit's participation in USDA guaranteed loan programs.

<u>Comment 3.</u> The proposed calculation of an investment limit is the 30-day average balance of investments divided by the 30-day average balance of loans. Loans are defined in 615.5131, which provides that loans are calculated <u>quarterly</u> at quarter end using <u>quarterly</u> ADB (including accrued interest and excluding allowance for loan loss adjustments). Therefore, in this case, using the <u>quarterly</u> average daily balances for investments and loans is more appropriate, because it limits distortions caused by seasonal fluctuations in loans and remains consistent with the definition in 615.5131.

Notwithstanding, we believe that total loans outstanding is an inappropriate benchmark for investments used in risk management. More appropriate options include (a) Earning Assets, (b) Loans Plus Mission-related Investments Plus UBEs Plus RBICs Plus FMAC MBS, or (c) Total Assets.

- If an Association were to transform "loans" into an "investment" (e.g., via securitization through Farmer Mac), any limit with loans as denominator would be inadvertently restrictive. System entities may utilize securitizations for liquidity, credit risk and capital management purposes, and therefore, we do not believe that converting loans into investment securities should cause a tighter constraint to be imposed on any other investment purpose. A denominator of (a), (b) or (c) would alleviate that predicament.

Accordingly, we request FCA to specify the limit as 10 percent of either earning assets or total assets, rather than 10 percent of loans. This specification will avoid inappropriately restricting investments when loans are converted to investments.

<u>Proposed 615.5142 (b) – Risk Management Requirements</u>

Proposed 615.5142 (b) would require an Association to evaluate its investment management policies and determine and document how its investment activities are conducted in accordance with the risk management processes and procedures identified in proposed 615.5142 (b) (1), (b) (2), and (b)(3). In general, we believe that these proposed requirements are appropriate, as they require appropriate policies, controls and practices, and also require an Association's investment management process to be appropriate for the size, risk, and complexity of the Association and its investment portfolio.

<u>Comment 4.</u> FCA requested comments on how the FCA can structure the documentation requirements so they do not impose undue regulatory burden on funding Banks or Associations. We believe that much of the documentation for each specific investment program (e.g., SBA and USDA loans) should be at the program level, rather than the individual security level, and that program documentation should address concentration limits, interest rate risk characteristics, investment process, and liquidity characteristics. Associations may also need documentation regarding asset class diversification, although the current proposal would limit Associations to a single asset class that poses no credit risk.

<u>Proposed 615.5142 (c) – Funding Bank Supervision of Association Investments</u>

Proposed 615.5142 (c) specifies that an Association must request approval to buy and hold investments from its funding Bank.

<u>Comment 5.</u> We believe FCA should clarify that approval should be sought for each specific investment program (e.g., SBA and USDA loans), rather than on an individual investment basis.

Bank Investment Regulations

The Farm Credit Council (FCC), on behalf of AgriBank and other System institutions, will provide the FCA with detailed comments on the proposed Bank investment regulations. AgriBank supports the FCC letter and emphasizes the following specific comments:

- Section 615.5140 (a)(1), *Purpose*. Requiring an additional, formal designation of investment purpose is unnecessary and does not add incremental value to the existing pre-purchase due diligence requirements that are designed to assess eligibility at the asset level.
- Section 615.5133 (f)(3)(i) – *Asset Class Diversification.* We propose money market investments continue to remain exempt from the asset class portfolio diversification limit. The addition of a 15 percent cap per asset class poses undue restriction on money market investments and limits their use as an effective investment vehicle for liquidity risk management.
- The Farm Credit Banks place a high importance on the risk-reducing benefits of money market investments. The short-term maturities make these investments self-liquidating, which provide the Banks with a reliable source of liquidity during periods of market stress. Self-liquidating means money market securities do not rely on the capital markets or the repo market for the ability to convert to cash, which provides diversification in the source of liquidity. In the post-crisis market and corresponding reduction in the size of dealer Bank balance sheets, money market investments makes relying on dealers for liquidity less important.
- Section 615.5133 (f)(3)(ii) and (g) - *Obligor Diversification, Farm Credit Bank Obligor Limit*. We propose the amount of capital Banks may invest in one obligor should be maintained as a percentage of total capital without the additional limit of 3 percent of total investment portfolio per obligor, which is unnecessary in light of the proposed regulatory obligor reduction from 20 percent to 10 percent of the total capital concentration.
- IV - *Compliance Date.* We ask the FCA to consider the impact of the specific changes made in the final regulations on each Bank's existing portfolio.

Please refer to the FCC letter for further explanation of and rationale for these comments.

We appreciate your consideration of our comments on the proposed Association and Bank investment regulations. Some individual System institutions will provide you with additional comments. Feel free to contact me with any questions.

Sincerely,

L. William York
Chief Executive Officer